Vision Super Pty Ltd

Vision Super - response to the Productivity Commission stage 3 issues paper: August 2017

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Introduction

Vision Super submitted a response to the Productivity Commission's issues paper on alternative default models. Many of the points we made in that submission remain relevant to the stage 3 issues paper.

The superannuation system has the basics right. The biggest threat to Australians' confidence in the system is continued unnecessary regulatory change. What the superannuation system needs is a long period of stability with any changes made only to address urgent issues that are putting Australians' retirement at risk, not further changes that may or may not prove to actually increase competition or engagement with superannuation. The government should declare a moratorium on any further changes to the superannuation system for at least the next five years.

The industry funds have lower costs for members on average than retail funds, and have outperformed retail funds over every period from 1 month to 15 years. Changes to default fund arrangements that would open up the sector to the retail funds are manifestly not in the best interests of members.

Current changes to fee disclosure rules and unclaimed super thresholds should be allowed to be implemented and their effectiveness assessed before the government moots further changes.

Insurance in super provides an important level of cover for Australians who are generally underinsured, acting as an important safety net for workers who would find it difficult to obtain cover by satisfying underwriting requirements, and generally provides cheaper cover via group discounts than members could obtain as individuals. The industry is responding to changing needs across the member lifecycle, and government intervention is unnecessary.

It is time for governments of both persuasions to start keeping the promises they make to leave the superannuation system alone. Australians' interests are best served by having a system of retirement savings they can rely on to operate on the same rules when they retire as it did when they started making contributions. Australian workers should not have to be worried that if they put their money into their super, the rules will change again and they will not be able to access it when they need to, or it will be taken in taxes, or they will be unable to rely on the provider their super sits with.

Our detailed response is set out below.

Stephen Rowe
Chief Executive Officer

21 August 2017

Responses

Costs, fees and net returns

The issues paper sets out that:

The Commission is to focus on assessing system-wide long-term net returns, including by reference to particular segments. Through this assessment, the Commission should have particular regard to:

•whether disclosure practices are resulting in a consistent and comparable basis for meaningful comparisons to be made between products;

•whether additional disclosure would improve outcomes for members;

•whether the system is minimising costs and fees (including, but not limited to exit fees) for given returns;

•what impact costs and fees have on members with low account balances, and what actions could be undertaken – whether by funds or policy changes – to ensure that these balances are not eroded needlessly; and

•whether tailoring of costs and fees for different member segments would be appropriate.

Vision Super's response

New standards for fee disclosures come into effect 1 October 2017, in the form of *Regulatory Guide 97: Disclosing fees and costs in PDSs and periodic statements*. Presumably the government believes these enhanced disclosure requirements will be effective in providing members with the ability to compare products more accurately, or they would not be instituting these new requirements. It therefore seems premature of the Productivity Commission to be considering whether current disclosure practices are adequate, rather than waiting to assess the impact of the new requirements post-introduction.

It is manifestly the case that industry funds are doing a better job of minimising fees than the retail super sector, with average fees of the MySuper option in an industry fund on a $50,000 balance at $501 a year, compared with $ $586 for the average retail fund's MySuper option.[1] The difference is more stark when it comes to choice members, with an average of $876 in fees being charged by retail master trusts, compared with a member of a not for profit fund, paying an average of $506 on the same $50,000 balance.

On the issue of tailoring costs and fees for different member segments, it is arguable that funds already do this through the charging of percentage fees based on members' account balances, as well as through the changing cost of insurance cover as members age, and it is difficult to see how this could be extended further without breaching the cross-subsidisation rules that protect individual members from losing benefits by effectively paying for other members.

The protection of members with low account balances is now largely being achieved through the transfer of unclaimed super to the ATO. The current threshold of $6,000 has only been in place since 1 January 2017. Vision Super believes the government should assess how effective this measure has been prior to seeking to introduce further measures that may prove unnecessary.

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[1] http://www.superguide.com.au/smsfs/feeding-frenzy-super-fund-fees

Default fund members

The issues paper sets out that:

In relation to default fund members, the Commission should consider:

•whether the current default settings in the system are appropriate, or whether policy changes would be desirable; and

•whether an alternative default fund allocation mechanism should be introduced that would deliver net benefits.

Vision Super's response

Vision Super reiterates our previous concerns raised in response to the Productivity Commission Issues Paper on Alternative Default Models. Australia's superannuation system has the basics right. The Melbourne Mercer Global Pension Index ranks the Australian retirement system among the top three in the world.[2]

Australians saving for retirement have compulsory contributions from their wages, made on their behalf by their employers into their super fund. They are protected by a range of measures, set out in legislation and regulations, that have been refined as the superannuation system has matured. Under the MySuper reforms, there are minimum standards funds have to meet in order for employers to be able to pay default contributions on behalf of their employees. Members of APRA-regulated funds are protected from having their money lost through fraudulent conduct or theft. Most Australians have a choice as to where their money is invested, having been able to choose the fund they prefer since 1 July 2005. Australians are taking advantage of that choice, as we know from our own experience – of Vision Super's recent new members, 41% are choice members. It is easier than it has ever been for individuals to keep track of their super and combine multiple accounts. The taxation of superannuation has been designed to incentivise savings – something we sorely need given our ageing population, and the need for spending on the aged pension to remain in check. Opt-out insurance arrangements through superannuation provide much-needed protection for Australians, who are typically underinsured[3], and their families.

It will still be some time until we get to the point where retirees will have had compulsory super their whole working lives, but when the superannuation guarantee eventually goes up to 12% it will put Australia's retirement funding on a more sustainable basis. Importantly, most low-paid workers, who are typically employed under awards or Enterprise Bargaining Agreements, have the added protection of having their retirement savings in a not-for-profit fund that is run to benefit them as members, and which have historically outperformed retail funds, returning more to members – which means they have more in their pockets when they want to retire.

It is arguable that the system is not perfect. However, it is very effective, there are appropriate consumer safeguards in place, and there are also important threshold questions that governments should be asking before seeking further changes to a system that has already been through enormous upheavals. The constant tinkering and speculation about superannuation changes at a federal level is eroding Australians' confidence in the super system, and will start to have a major negative impact on contribution flows.

Governments need to be asking whether seeking changes based on ideological grounds, such as increasing competition or changing default arrangements, will benefit consumers more than the changes further undermine the system.

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[2]http://www.globalpensionindex.com/wp-content/uploads/Melbourne-Mercer-Global-Pension-Index-2015-Report-Web.pdf

[3] According to KPMG research, the level of underinsurance of the lives of employed people in Australian families is an estimated $800 billion against premature death, and $304 billion per annum against disability (http://fsi.gov.au/files/2014/09/KPMG.pdf)

The superannuation system is functioning well and leading to better retirement outcomes for Australian workers. There is little to be gained and much to be lost by continuing to tinker with a system that is not broken. Instead, the superannuation system needs is a long period of stability with any changes made only to address urgent issues that are putting Australians' retirement at risk, not further changes that may or may not prove to actually increase competition or engagement with superannuation. The government should declare a moratorium on any further changes to the superannuation system for at least the next five years.

Vision Super believes members' best interests should be the paramount concern when considering whether an alternative default fund allocation mechanism should be introduced.

The current default settings have meant the majority of Australians have their retirement savings with an industry super fund. As mentioned above, the average fees of an industry fund than those of the average retail fund.[4] Industry funds have also consistently outperformed retail funds over every time period:

Table 3: Performance by Industry Segment (Results to 30 June 2017)

	1 Mth (%)	Qtr (%)	1 Yr (%)	3 Yrs (% pa)	5 Yrs (% pa)	7 Yrs (% pa)	10 Yrs (% pa)	15 Yrs (% pa)
Industry Funds	0.3	2.3	11.1	8.5	10.8	9.1	5.2	7.5
Retail Funds	-0.3	1.5	9.7	7.1	9.9	8.4	4.4	6.5

Source: Chant West

Note: Performance is shown net of investment fees and tax. It is before administration fees and adviser commissions.

Industry funds have a structural advantage over their retail competitors; there is no obligation to pay shareholders before members. This structural advantage, along with a willingness to invest in longer-term infrastructure projects where retail funds prefer to remain in more liquid vehicles, explains the superior outcomes for members.

Despite a perceived lack of competition, default fund arrangements leave workers manifestly better off than they would be with retail funds.

Further, those covered by awards and enterprise agreements tend to be lower-skilled, lower paid workers,[5] who are the most likely to be low in financial literacy skills according to ANZ's financial literacy research[6] - those who are most likely to be with their employer's default fund, and the least likely to have the skills to pick a super fund for themselves.

There is no evidence that opening up default fund status to further competition would lead to increased active participation by members, or that allowing employers to select the fund they prefer would lead to better outcomes for members. There is no evidence that the current state of play has led to higher fees, lower quality products or the erosion of member balances – quite the opposite in fact. And there is plenty of evidence that continued changes to the superannuation system are detrimental to the system - even if removing default funds did offer marginal benefits in terms of competitiveness or enhanced member engagement, the benefit may well be cancelled out by the resulting disengagement caused by the further changes. The best interests of members and the stability and integrity of the superannuation system are best served by leaving default arrangements as they are, rather than beginning an ideological crusade to open the super system up to the scandal-ridden banks who cannot keep themselves off the front pages.

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[4] http://www.superguide.com.au/smsfs/feeding-frenzy-super-fund-fees

[5] Ibid

[6] http://www.anz.com/resources/3/1/31cbc1fd-9491-4a22-91dc-4c803e4c34ab/adult-financial-literacy-survey-full-results.pdf

Insurance in superannuation

The issues paper sets out that:

The Commission should consider the appropriateness of the insurance arrangements inside superannuation, including:

•the impact of insurance premiums on retirement incomes of both default cover and individually underwritten cover funded inside of superannuation;

•the extent to which current policy settings offset costs to government in the form of reduced social security payments;

•whether policy changes could improve default cover through superannuation, so that default cover:

- provides value-for-money;

- does not inappropriately erode the retirement savings of members of all ages; and

- delivers consistent outcomes across the system; and

•whether policy changes are needed to ensure that insurance is not a barrier to account consolidation.

Vision Super's response

Australians are underinsured. Only 27% of Australian workers have income protection insurance, and just 25% have death cover.[7] This gap is at least partly caused by a knowledge gap, with only 19% of Australians having good or very good knowledge of disability insurance, and 15% having good or very good knowledge of premature death insurance – nearly half (47%) report little or no knowledge of premature death cover.[8]

Against this backdrop, insurance within the superannuation system is the closest thing we have to a universal base level of cover for Australian workers, with more than 70% of all life cover provided via superannuation.[9] With little to no underwriting, a high ratio of claims paid, and lower prices than retail cover, for most Australians cover through their super is the only life insurance they have.

The scandal-ridden banks are the next biggest provider of insurance, and manifestly cannot be trusted to act in the best interests of Australians. The most recent coverage of the Commonwealth Bank's "issues" includes revelations that they may have been selling lines of insurance that wouldn't have been paid out, over insurance for home loan customers, and failure to cancel existing insurance products for deceased estates.[10] Coming on top of earlier revelations of out-dated medical definitions, bank-employed doctors being pressured to change their customer assessments to decline payouts, delaying payouts to the terminally ill, and refusing the claims of former staff who were medically retired,[11] it is difficult to see why the Government would wish to hand over a larger segment of the insurance market to the retail market.

Aside from the tarnished image of the retail providers, retail insurance typically includes underwriting requirements, meaning Australians with existing health conditions cannot obtain cover, and those working in some sectors would find it difficult, if not impossible, to obtain insurance.

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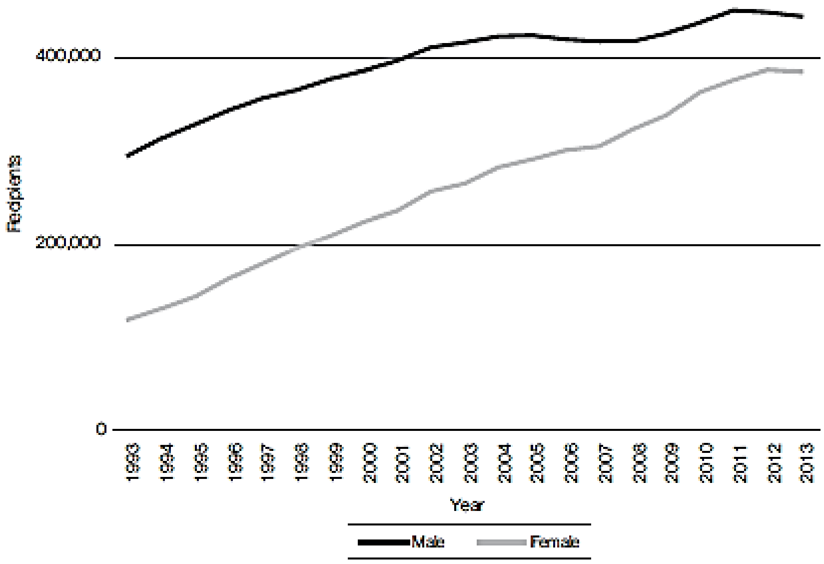
[7] https://www.zurich.com.au/content/dam/au-documents/news/income-protection-gaps-challenge-and-opportunity.pdf
[8] Ibid
[9] http://www.ricewarner.com/insurance-through-superannuation/
[10] http://www.abc.net.au/news/2017-08-15/cba-updates-settlements-with-clients-and-employees/8805872
[11] http://www.smh.com.au/business/banking-and-finance/comminsure-scandal-to-hit-cba-brand-again-20160308-gndj4y.html

Each year, insurance through super pays out disability benefits to around 17,000 Australians.[12] Although little research appears to have been done into how much insurance saves the taxpayer, prima facie those 17,000 Australians who have disability benefits paid through their insurance must be reducing the cost of disability support pensions. The most recent publicly available figures from the Department of Human Services show 821,738 Australians are receiving a Disability Support Pension, and that the number has more than doubled over the past two decades.[13] The Government has indicated that this has a total cost to the Budget of around $17 billion.[14] This equates to just over $20,600 per recipient.



Source: DHS administrative data.

On top of this, Sickness Allowance is paid to Australians who are temporarily unable to work due to a medical condition. In 2013, 7,494 Australians received this benefit.[15]

Both the Disability Support Pension and Sickness Allowance are subject to income and assets tests. People receiving income protection payments from their insurance would generally not meet the income test, which potentially means savings to the government of up to $351,000,000 a year, based on the government's numbers.

It is indubitably the case that paying insurance premiums through super has an impact on retirement savings, just as for many Australians paying insurance premiums outside super – including health insurance, home and contents insurance, car insurance, and retail life and disability cover - affects both disposable income and ability to save for the future, both inside and outside the superannuation system. This does not mean change is needed. Premiums through super are generally lower than those available to retail customers, thanks to the ability of super funds to negotiate group discounts, and as noted above, the cover is available to those who would find it difficult to obtain retail cover. Few would argue though that Australians should give up their home and contents insurance in order to save more for retirement. Given the knowledge gap referred to above, it would also be difficult to argue that purchasing life,

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[12] http://www.ricewarner.com/insurance-through-superannuation/

[13] https://www.dss.gov.au/publications-articles/research-publications/statistical-paper-series/statistical-paper-no-12-income-support-customers-a-statistical-overview-2013

[14] http://www.theaustralian.com.au/national-affairs/disability-support-pension-burden-hits-17bn-a-year/news-story/61692e10aead22629717d810ca046376

[15] Ibid

disability and income protection insurance could be left entirely to the market without dire consequences for Australians who experience disability or the death of an income earning spouse or parent.

The Super System Review noted that:

The Panel considers that life and TPD insurance strongly supports the principles of the superannuation system. The Panel believes that in the MySuper sector, where members are least likely to give consideration to their insurance needs, the trustee should be required to offer life and TPD insurance on an opt-out basis. Requiring MySuper products to offer life and TPD insurance on an opt - out basis provides a safety net to members who might otherwise not consider their insurance needs; a view supported by many submissions. This will lower the cost of insurance for most members in MySuper, because there is pooling of risk between members who face different risks and financial circumstances. However, those MySuper members who do give consideration to their insurance situation would be able to opt-out or to purchase additional units of cover (if offered by the trustee).

Recommendation 5.1: Life insurance cover and TPD cover (where available, depending on occupational and demographic factors) must be offered on an opt-out basis in MySuper products.

The Panel believes, however, that where members decide to accept the financial risks of death or disability, perhaps because they have no dependants, or would prefer to take out insurance outside their superannuation, then this should be allowed. The retirement benefits of members should not be reduced by unwanted, but compulsory, insurance.

The reasons for the Panel's recommendation have not changed since MySuper was introduced. It is still the case that people in the MySuper sector are those least likely to consider their insurance needs, and it is still the case that super funds are in a position to offer lower cost insurance. It is also still the case that members can choose to opt out of the default arrangements.

It is arguable that in the past some funds have offered default insurance arrangements that have eroded the balances of some younger members, however the way cover is offered is shifting, with recent reports indicating that the average level of cover offered to younger fund members has dropped by 20% over the past two years, resulting in lower costs.[16] As most insurance contracts run for three years, it takes some time for shifts to happen, but the industry is responding appropriately to the issue, and government intervention is unnecessary.

[16] http://www.afr.com/personal-finance/superannuation-and-smsfs/superannuation-funds-reduce-default-cover-for-younger-members-20170811-gxuhra